

FISCAL POLICIES AND BASIC ASSUMPTIONS



CITY OF
CHULA VISTA

FISCAL POLICIES

This section of the budget document reiterates the fiscal policies that were reviewed and acknowledged by the City Council in January 2000. These policies along with some basic assumptions discussed in the subsequent section form the overall framework within which the spending plan was formulated. Neither the fiscal policies, most of which are already codified in one form or another, nor the assumptions are considered new or controversial, but are summarized here to assist you to better understand the basis for the resource allocation decisions that were made.

A. General

1. The City's financial assets will be managed in a sound and prudent manner in order to ensure the continued viability of the organization.
2. A comprehensive Financial Plan will be developed and presented to the City Council for approval every two years. The purpose of the Two Year Financial Plan will be to:
 - a. Identify community needs for essential services.
 - b. Identify the programs and specific activities required to provide these essential services.
 - c. Establish program policies and goals that define the nature and level of program services required.
 - d. Identify alternatives for improving the delivery of program services.
 - e. Identify the resources required to fund identified programs and activities, and enable accomplishment of program objectives.
 - f. Set standards to facilitate the measurement and evaluation of program performance.
3. Recurring expenditures will be funded by recurring revenues. One-time revenues will be used for capital, reserve augmentation, or other non-recurring expenditures.
4. Accounting systems will be maintained in accordance with Generally Accepted Accounting Principles.
5. Investment policy and practice will be in accordance with State statutes that emphasize safety and liquidity over yield, including quarterly status reports to the City Council. *(Council Policy)*
6. General Fund fiscal status reports reflecting comparisons of actual and projected performance with budget allocations for both revenues and expenditures will be presented to the City Council on a quarterly basis. *(City Charter)*
7. City operations will be managed and budgets prepared with the goal of maintaining an available fund balance in the General Fund of no less than eight percent of the General Fund operating budget. *(Council Policy)*

B. Revenue

1. The City will endeavor to maintain a diversified and stable revenue base in order to minimize the impact to programs from short-term economic fluctuations.
2. Revenue projections will be maintained for the current year and four future fiscal years, and estimates will be based on a conservative, analytical, and objective process.
3. In order to maintain maximum flexibility, except as required by law or the funding source, the City will avoid earmarking any unrestricted revenues for a specific purpose or program.
4. User fees will be imposed when appropriate and set at a level to recover the full cost of services provided which are of a special benefit to easily identified individuals or groups.
5. User fees will be reviewed and updated on an ongoing basis to ensure that program costs continue to be recovered and that the fee reflects changes in methods or levels of service delivery.
6. The City will recover the cost of new facilities and infrastructure necessitated by new development consistent with State law and the City's Growth Management Program. Development Impact Fees will be closely monitored and updated to insure that they are maintained at a level adequate to recover costs. *(GMOC Ordinance)*
7. When considering new development alternatives, the City will attempt to determine the fiscal impact of proposed projects, annexations, etc. and insure that mechanisms are put in place to provide funding for any projected negative impacts on City operations. *(GMOC Ordinance)*

C. Expenditures

1. Budgetary control will be exercised at the Department/category level, meaning that each department is authorized to spend up to the total amount appropriated for that department within the expenditure categories of Personnel Costs, Supplies & Services, Other Charges, and Capital. Transfers of appropriations between expenditure categories of up to \$15,000 may be approved by the City Manager. Transfers of appropriations between expenditure categories in excess of \$15,000, or between departments require City Council approval. *(City Charter & Council Policy)*
2. Appropriations, other than for capital projects, remaining unspent at the end of any fiscal year will be cancelled and returned to Available Fund Balance with the exception of any appropriations encumbered as the result of a valid purchase order or as approved for a specific project or purpose by the City Council or the City Manager. Appropriations for capital projects will necessarily be carried over from year to year until the project is deemed to be complete. *(Council Policy)*

3. The City will establish and maintain vehicle, computer equipment, and other replacement funds as deemed necessary to ensure that monies are set aside and available to fund ongoing replacement needs.
4. The City will attempt to compensate non-safety employees at rates above the middle of the labor market as measured by the median rate for similar jurisdictions. (*Council Policy*)

D. Capital Improvement Program (CIP)

1. Major capital projects will be included in a CIP Budget reflecting a five-year period, which will be presented to the City Council for approval every two years. Resources will be formally appropriated (budgeted) for the various projects on an annual basis in accordance with the five-year plan.

E. Capital Financing & Debt Management

1. The City will consider the use of debt financing only for one-time capital improvement projects when the project's useful life will exceed the term of the financing and when resources are identified sufficient to fund the debt service requirements. The only exception to this limitation is the issuance of short-term instruments such as tax and revenue anticipation notes, which will only be considered in order to meet legitimate cash flow needs occurring within a fiscal year.
2. The City will attempt to limit the total amount of annual debt service payments guaranteed by the General Fund to no more than ten percent of estimated General Fund revenues.
3. The City will consider requests from developers for the use of debt financing secured by property based assessments or special taxes in order to provide for necessary infrastructure for new development only under strict guidelines adopted by Council, which may include minimum value-to-lien ratios and maximum tax burdens. (*Community Facility District Ordinance*)
4. The City will strive to minimize borrowing costs by:
 - a. Seeking the highest credit rating possible.
 - b. Procuring credit enhancement such as letters of credit or insurance, when cost effective.
 - c. Maintaining good communications with credit rating agencies regarding the City's fiscal condition.
5. The City will diligently monitor its compliance with bond legal covenants, including adherence to continuing disclosure requirements and federal arbitrage regulations.
6. In addition to externally financed debt, the City utilizes inter-fund loans whenever possible to reduce borrowing costs or provide for shorter term loans. When interest is charged on internal loans, it is done at the same rate the City earns from its investments.

BASIC SPENDING PLAN ASSUMPTIONS

A. Personnel Costs

All positions are budgeted at the projected actual cost of each individual position at the same time a reasonable, but necessarily conservative, assumption is made of anticipated “salary savings” due to normal turnover and hiring delays during the year. These amounts have been “taken out” of the budget up front.

B. Training

It is important to ensure that employees have adequate training in order to keep them current in their professions and areas of specialization, and the budget includes an appropriate level of funding for training purposes. This is seen as an important factor in attracting and retaining good employees. Well-informed, well-trained employees keep the City functioning well, anticipate issues before they become problems, and provide the high level of service for which Chula Vista is known.

C. Quality Equipment & Tools

In order for all City employees to work at their top level of performance, they need access to the most effective and efficient equipment. We continue to be committed to maintaining state-of-the-art computer networks and ancillary equipment. In fiscal year 2001, the Council approved a fully funded Technology Replacement Fund in order to accumulate monies on an annual basis for computer equipment replacement in accordance with a reasonable replacement schedule. In addition, as funding allows, staff is also continuing to work toward replacement of outdated office equipment and installing ergonomic workstations.

D. Vehicle Maintenance & Replacement

This budget includes adequate funding for vehicle maintenance costs and funding of the annual accumulation of vehicle replacement costs to ensure that adequate funds are available to replace vehicles in accordance with a prudent replacement schedule based on mileage and other factors.

E. Net City Cost Concept

Direct service programs that should be funded by fees or other program generated revenues are evaluated based on “net city cost”. The basis for this concept is that individual programs are funded in various degrees by revenues generated by the program itself, and then either not at all or only partially by discretionary General Fund revenues, such as property tax and sales tax. That portion funded by discretionary revenues is termed the net City cost of the program.

As the budget is being formulated, any change in the net city cost of a specific program is evaluated to determine if a service level adjustment should be considered rather than

increasing the funds allocated to the specific program. This ensures the maximum amount of discretionary revenues remain available to fund those important basic City functions, such as public safety and infrastructure maintenance, that do not typically generate a significant amount of program related revenue.

One of the best examples of this concept is in the area of Development Processing Agreements. In order to provide for efficient review and processing of the many major development proposals in the eastern area of Chula Vista, the City has entered into development processing agreements with developers. Under these agreements, developers pay for all City services needed to process their projects. Using the net city cost concept, this budget contemplates that growth in the form of new development pays for itself. This follows the City's adopted Growth Management Plan and avoids any negative impact on basic services throughout the City.

ACCOUNTING SYSTEMS AND BUDGETARY CONTROL

The City's accounting records and budget are prepared and maintained using a modified accrual basis of accounting, which follows the accounting practices for governmental units as recommended by the Governmental Accounting Standards Board. Basic City operations are accounted for in the City's General Fund, with other activities accounted for in separate funds as required by law or determined by management discretion. Generally, revenues are recorded when measurable and available, and liabilities are recorded when incurred.

In administering the City's accounting systems, primary consideration is given to the adequacy of internal accounting controls, which include an array of administrative procedures. These controls are designed to provide reasonable, but not absolute, assurance regarding the safeguarding of assets against loss from unauthorized use or disposition, as well as the reliability of financial records for accurate and fair presentation of financial reports. The concept of reasonable assurance recognizes that the cost of specific controls should not exceed the benefits likely to be derived from exercising the controls, and that this evaluation necessarily involves estimates and judgments by management. It is believed that the City's internal accounting controls adequately safeguard City assets and provide reasonable assurance of proper recording of financial transactions.

The City Charter charges the Director of Finance with the responsibility to supervise and be responsible for the disbursement of all monies and have control over all expenditures to insure that budget appropriations are not exceeded. The level of budgetary control, that is the level at which expenditures are not to exceed Council approved appropriations, is established at the department and expenditure level (e.g., personnel services, supplies and services, capital). Any budget modification that would result in an appropriation increase requires City Council approval. The City Manager and Finance Director are jointly authorized to transfer up to \$15,000 of appropriations between expenditure categories within a departmental budget. Any appropriations transfers between departments require City Council approval. An encumbrance (commitment) accounting system is utilized as a technique to enhance budgetary control during the year. Appropriations encumbered (committed) at year-end may be carried forward with City Manager approval and are available to be used for those commitments during the subsequent year. Unspent and unencumbered appropriations lapse at year-end and become generally available for re-appropriation the following year.

COST ALLOCATION PLAN

In providing direct public services to its citizens (i.e. public libraries, parks and recreational facilities, street and sewer maintenance, public safety), the costs incurred by the City extend far beyond “direct” staff salaries. Two of the primary costs over and above staff salaries are fringe benefits and paid time off. Fringe benefits for full time City employees include participation in the Public Employee Retirement System (PERS), medical insurance, vacation and sick leave buy back, and car allowances. Paid time off includes vacation time, holidays, sick leave, comp time, and management leave. A full accounting of the costs associated with providing any type of service must include all of these expenses.

Contributing even more significantly to total public service costs are the indirect costs of “doing business”. For example, personnel staff are needed to handle recruitment and hiring, payroll staff are needed to pay salaries, supervisors are needed to provide direction and training, secretaries are needed to keep records and provide administrative support, and managerial staff are needed to make organizational decisions. Furthermore, City staff requires office space with furnishings, computer systems, and a variety of office and field equipment. Combined, the indirect costs associated with providing a public service can potentially exceed the direct salary costs.

Given the magnitude of indirect costs, the City chose in September of 1982 to adopt a policy of full cost recovery, under which both the direct and indirect costs associated with providing public services are identified and, when possible, recovered. In defining direct and indirect services, the City follows the conservative lead of the federal government guidelines for grant reporting contained in OMB Circular A-87. While this method assures appropriate billing on grants, it defines some costs as direct that would normally be considered indirect functions. To limit the impact these restrictions could have on overall cost recovery, a separate “grant restrictions” set of full cost recovery factors has been calculated. These more stringent standards prohibit the recovery of certain indirect costs such as department heads and administrative secretaries in addition to accounting, procurement, and personnel functions.

Indirect costs were allocated to the various City departments using multiple “drivers”. For example, the costs associated with procurement were allocated following budgeted supply and service dollars while the costs associated with telephone support were allocated following the number of office employees. This greatly improved the accuracy of the indirect cost allocation by more realistically linking support services to direct service programs.

DEBT ADMINISTRATION

Based on the audited financial statements for the year ended June 30, 2004, the City and Agency had borrowed funds through several long-term debt issues and had other obligations to be funded over a period of time longer than one year, which can be categorized as follows:

Description	Amount Outstanding
Tax Allocation Bonds	\$42,125,000
Pension Obligation Bonds	13,985,870
Certificates of Participation	92,920,000
Capital Leases	2,288,808
Notes/Loans Payable	406,385
Miscellaneous Claims Payable	8,164,554
Compensated Absences (Employee Leave)	<u>4,620,778</u>
Subtotal	\$164,511,395
Advances from other Funds	<u>59,043,057</u>
Total Long Term Debt	<u>\$223,554,452</u>

The Long-Term Debt total reflects a decrease of \$6,461,374 when compared to the prior year amount. The largest decrease occurred in the Certificates of Participation category because two issues were paid off as discussed below.

The annual debt service payments during this fiscal year amounted to \$21,228,578 of which \$6,391,306 was an obligation of the City and \$14,837,272 an obligation of the Redevelopment Agency (Agency). Additionally, included in the Redevelopment Agency obligation are one-time payments made to pay off two issues totaling \$9,801,179. When this one time payment is deducted the combined City and Agency debt service was actually \$11,873,578.

Tax Allocation Bonds (\$42.12 million)

Tax Allocation Bonds (TABS) are issued by the Agency and utilize tax increment revenue for debt service. The 1994 TABS Series A, C and D were issued to refund prior obligations of the Bayfront and Town Center 1 project areas. The 2000 TABS were issued by the Southwest, Otay Valley and Town Center 2 project areas to finance certain redevelopment activities in those areas.

Pension Obligation Bonds (\$13.98 million)

The Pension Obligation Bonds represent money borrowed in 1994 to allow the City to pay down the liability to the Public Employees' Retirement System that had accumulated over many years, and for which the City was being charged a higher interest rate than was obtained by this borrowing.

Certificates of Participation (\$92.9 million)

The City currently has outstanding three Certificates of Participation (COP) as of June 30, 2004. The City's most recent issue is the 2003 Refunding COP which was used to defease

two 1993 COPs totaling \$9.355 million (1993 Refunding COP \$7.215 million and 1993 COP \$2.140 million). Additionally, the City has a 2000 COP issued to finance improvements to the City's 800 megahertz emergency communications system and make improvements to the City's Corporation Yard. The 2002 COP was issued to finance the cost of constructing the City's Police Facility.

Capital Leases (\$2.3 million)

The Capital Leases represent two long-term lease-purchase obligations for the San Diego County Regionalized Communications System and for replacement of the library's computerized catalog and circulation system.

Notes/Loans Payable (\$0.4 million)

The majority of the Notes/Loans Payable represent the City's or Agency's commitment to repay others for a portion of their initial investment in commercial endeavors within the City based on expected sales tax growth accruing to the City.

Miscellaneous Loans Payable (\$8.2 million)

The Miscellaneous Claims Payable represents the probable amount of loss as estimated by legal counsel and risk management staff due to worker's compensation and general liability claims filed against the City.

Compensated Absences (\$4.6 million)

The obligation for Compensated Absences represents the current dollar value of accumulated leave balances, primarily vacation leave, for employees that would have to be paid off if all employees terminated for whatever reason as of June 30, 2004.

Advances From Other Funds (\$59.0 million)

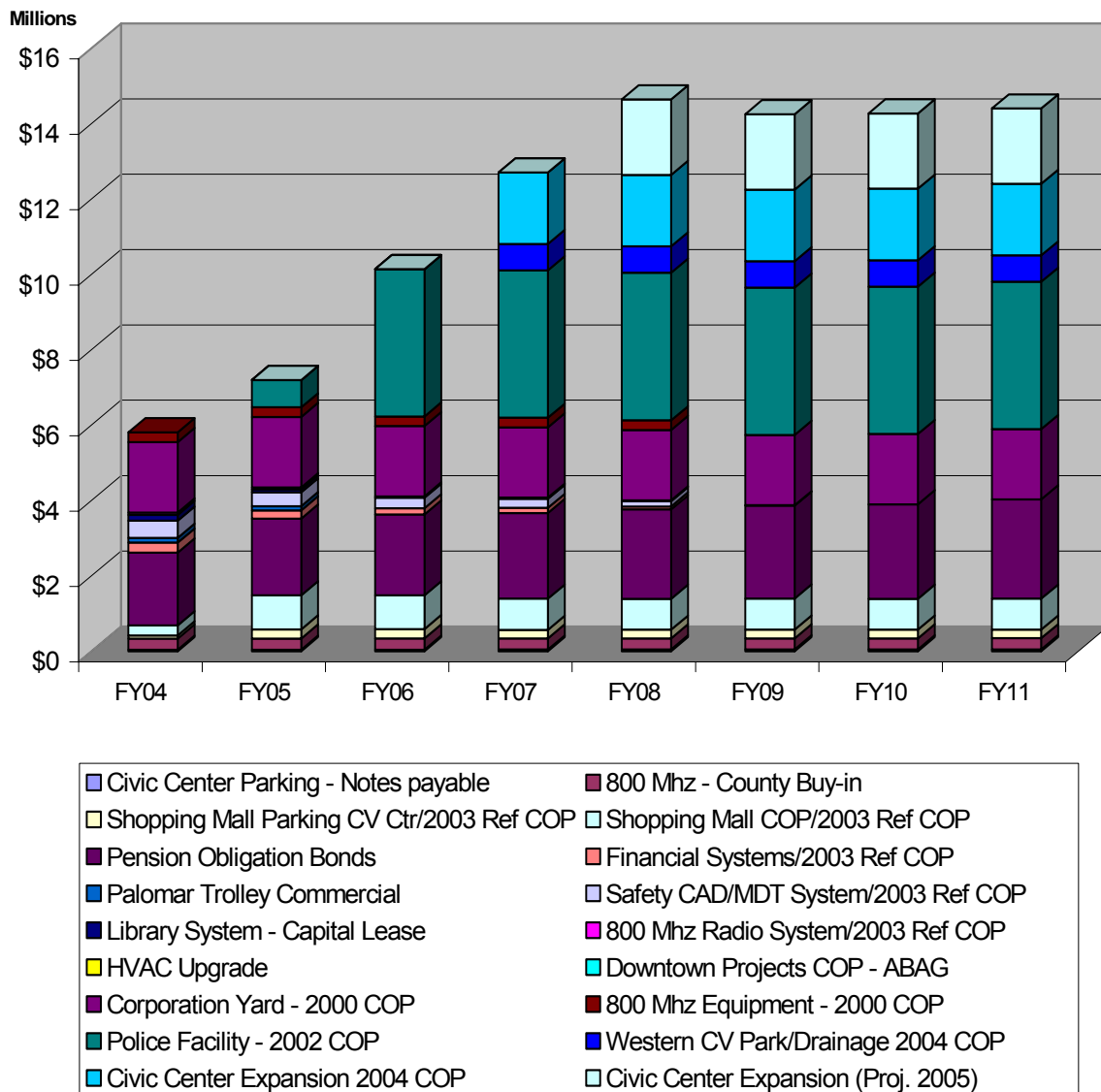
Advances from Other Funds include obligations related to the Agency. The balance includes \$7.4 million of funds loaned from the Bayfront/Town Center 1 Project Area to various Capital Project Funds. In addition, the Agency has entered into various loans and obligations covered under reimbursement agreements with the City totaling \$20.1 million for certain lease payments and \$3.8 million for operating purposes. These obligations have been incurred to support various redevelopment activities throughout the City.

Other amounts included in Advances from Other Funds are loans from Trunk Sewer and Sewer Replacement Funds to the Storm Drain Fund (\$1.6 million). The Trunk Sewer Fund has further advanced loans to the Special Assessment District Improvement Funds (\$0.1 million) and to the Salt Creek DIF (\$14.2 million) for major sewer projects needed to support continued growth. The SR125 DIF advanced \$10.8 million to the Transportation Development Impact Fee Fund for traffic related projects and the Corporation Yard Relocation fund advance \$1.0 million to the General Fund for the Animal Shelter expansion.

General Fund Long-Term Debt for Fiscal Year 2005

During fiscal year 2005 the City issued \$37.24 million in COP debt for Phase 1 of the Civic Center remodel and Western Chula Vista Infrastructure Improvements (\$9.0 million). Debt service on the issue will not commence until fiscal year 2006/07 because interest will be paid from a reserve account funded from the bond proceeds.

Annual Debt Service Obligation of the General Fund Fiscal Years 2003/04 –2010/11



The General Fund' s annual debt service " commitment" in fiscal year 2005 was approximately \$7.3 million, or approximately 5.0% of the projected General Fund operating budget. However, it must be noted that although this amount is truly a General Fund commitment, only \$4.9 million was actually paid from General Fund resources, with the remaining \$2.4 million paid from development fees, residential construction taxes etc.. This \$4.9 million represents approximately 3.3% of the projected General Fund operating budget, which would be considered more of an average debt burden for a local governmental entity. By fiscal year 2007 debt service payments for the Civic Center' s Phase 1 and 2 COPs will begin. The annual debt service is estimated to be \$14.6 million or 8.6% of the projected General Fund operating budget.

GANN APPROPRIATIONS LIMIT

Article XIIB of the California Constitution, approved by the voters in 1979, imposed the concept of spending limits on local governments. This Constitutional provision and related implementing legislation specifies that annual increases in appropriations financed from "Proceeds of Taxes" are limited to a base year (1978-79) amount increased annually by an inflation factor comprised of the change in population of the City combined with the greater of the change in new non-residential construction or the change in the California per capita personal income. By definition, "Proceeds of Taxes" includes such revenues as property taxes, sales and use taxes, utility users taxes, transient occupancy taxes, and state subventions. Revenues from other sources like fees/charges and federal grants are considered "Non-Proceeds of Taxes" and are not subject to the annual spending limit. This calculation has always been perfunctory for the City of Chula Vista, since the proceeds of taxes for the City are far less than the statutory appropriation limit.

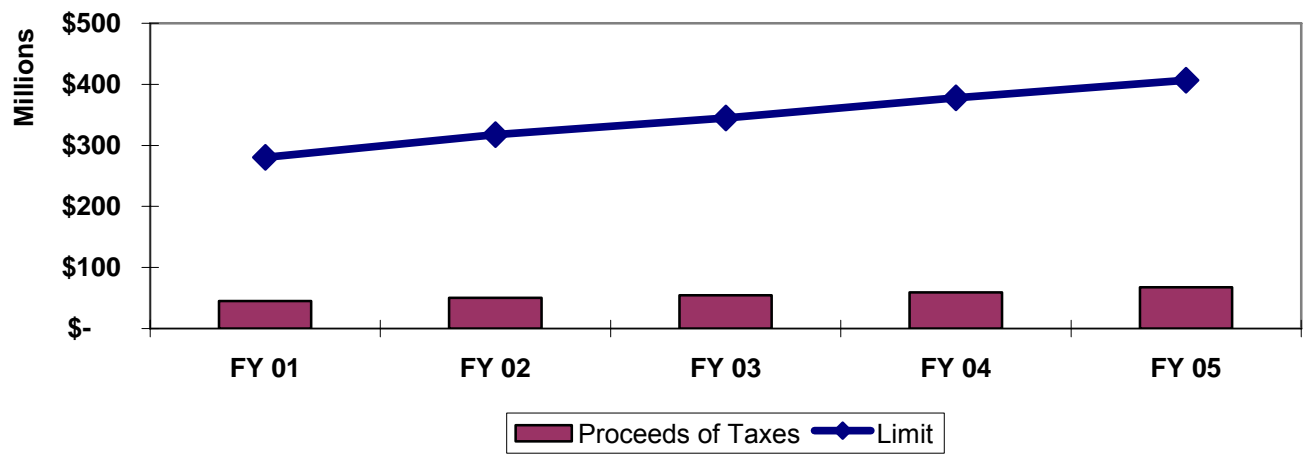
The State Department of Finance and the San Diego County Assessor's Office are charged with providing the data necessary for local jurisdictions to establish their appropriation limit. According to these sources, for purposes of the fiscal year 2005 calculation, the City's population increased 4.24 percent and California per capita personal income increased by 3.28 percent. New non-residential construction increased 1.30 percent and was not used in the formula to compute the limit since this increase was lower than the increase in California per capita personal income.

The fiscal year 2005 Appropriation Limit has been calculated as follows:

Fiscal Year 2004 Appropriation Limit	\$377,929,449
Increased by an inflation factor composed of the increases in population and per capita income change	<u>X 1.0766</u>
Fiscal Year 2005 Appropriations Limit	<u>\$406,875,338</u>

The "Proceeds of Taxes" as included in the fiscal year 2005 budget that are subject to the appropriations limit are estimated to be \$67,463,884. Therefore the City has what is referred to as an appropriation "gap" of \$339,411,454 (\$406,875,338 - \$67,463,884). Simply stated, this means that the City could collect and spend up to \$339,411,454 more in taxes during fiscal year 2005 without exceeding the Constitutional limit. As the following chart indicates Chula Vista has traditionally been well below the legal spending limit.

Proceeds of Taxes Compared to Legal Spending Limit



LEGAL DEBT MARGIN

Under State law, the City has a legal debt limitation not to exceed 15% of the total assessed valuation of taxable property within City boundaries. In accordance with California Government Code Section 43605, only the City's general obligation bonds are subject to that legal debt limit of \$2,251,535,741, the City is not at risk of exceeding that limit. The City of Chula Vista currently has no General Obligation Bonds outstanding. The table below summarizes the City's debt limit margin.

Computation of Debt Limit Margin Years ended 2003 through 2005

	2003	2004	2005
Total Assessed Valuation	\$ 11,848,542,395	\$ 13,224,121,249	\$ 15,010,238,271
Debt Limitation-15% of Assessed Valuation	\$ 1,777,281,359	\$ 1,983,618,187	\$ 2,251,535,741
Less: General Obligation Bonds Outstanding	\$ -	\$ -	\$ -
Legal Debt Margin	\$ 1,777,281,359	\$ 1,983,618,187	\$ 2,251,535,741